

CASH FLOW STATEMENT & BALANCE SHEET GUIDE

The Agriculture Development Council has established a new requirement for Growth Through Agriculture applications. Now, applications must be accompanied by a cash flow statement and balance sheet that provide annual financial projections for the business submitting an application. If the applicant business is already in existence, a balance sheet and cash flow statement should also be provided for the most current completed fiscal year.

To help applicants, the Montana Department of Agriculture developed a set of sample financial statements and developed a spreadsheet template for generating a cash flow statement and balance sheet. Applicants are not required to use the Department's spreadsheet template; however, projected cash flow statements and balance sheets must provide similar and equivalent information. Applicants who need assistance preparing projected financial statements are encouraged to contact a Montana Food and Agricultural Development Center (<http://agr.mt.gov/foodandag/default.asp>), Small Business Development Centers (<http://sbdc.mt.gov/default.mcpdx>), local or regional economic development corporations (<http://businessresources.mt.gov/default.mcpdx>), competent accounting firms, or other business professionals.

Existing Businesses

Existing businesses should provide cash flow and balance sheet information for the most recent completed fiscal year and for future years. If the Department's spreadsheet template is used, existing businesses should enter the most recent fiscal year's information in the "Prior Year" column and then enter projections in the columns for Year 1 – Year 5.

Startup Businesses

Startup businesses should provide cash flow and balance sheet projections from the time of startup. Startup businesses should start providing information in the "Year 1" columns.

Number of Years for Projections

Projections presented in the financial statements should be provided for the number of years of operation necessary to achieve both ***positive operating cash flows*** (defined later) and ***positive net income***. An explanation of operating cash flows and other accounting terminology is provided in the following, along with specific expectations for cash flow statements and balance sheets prepared to accompany Growth Through Agriculture applications.

Key Assumptions

Any ***major financial assumptions must be listed in a separate document*** that will accompany the projections. These assumptions may include things like why sales are projected to increase, why costs of goods sold are projected to remain stable or why the wages are projected to decrease.

CASH FLOW STATEMENT

A cash flow statement consists of the following main components:

- Cash Flow From Operating Activities
- Cash Flow From Investing Activities
- Cash Flow From Financing Activities
- Net Cash Flow
- Beginning Cash Balance
- Ending Cash Balance
- Reconciliation of Net Income to Operating Cash Flow

Cash Flow From Operating Activities

This section of the cash flow statement records cash received from sales and services and cash paid for operating expenditures (including interest). The example and spreadsheet template use what is called the direct method. This method provides more useful information and is more logical for many people to understand. The example and template include a row for expenditures of grants for operations. If Growth Through Agriculture grant funds are being used for operating activities, the expenditure should be identified as its own single expenditure category in this section of the cash flow statement.

Cash Flow From Investing Activities

This section of the cash flow statement records cash received from the sale of investments and fixed assets (land, buildings, equipment) or the sale of intangible assets and cash receipts from investment income. It also records cash paid for the purchase of investments, fixed assets, or intangible assets or the cost of fixed assets and intangible assets constructed/developed internally by the business. If Growth Through Agriculture grant funds are being used for financing activities, the expenditure should be identified as its own single expenditure category in this section of the cash flow statement.

Cash Flow From Financing Activities

This section of the cash flow statement records cash received from lending sources, equity investment by owners, and grant income received from the Growth Through Agriculture Program or other grant sources. It also records the principal portion of payments made on loans, returns of grant funds, and distributions made to owners (such as owner draws for proprietorships and partnerships or dividends and stock redemptions for corporations).

Net Cash Flow

This is the sum of Cash Flow from Operating Activities, Cash Flow from Investing Activities, and Cash Flow from Financing Activities.

Beginning Cash Balance

This is the balance of the cash accounts as of the end of the previous fiscal year.

Ending Cash Balance

This is the sum of Net Cash Flow and Beginning Cash Balance. It is the cash balance as of the end of the fiscal period.

Reconciliation of Net Income to Cash Flow From Operating Activities

This is an integral part of the cash flow statement that ties Net Income to Cash flow From Operating Activities. Net income is what measures the profit or loss for the fiscal period. It is the change in the net worth of the business for the fiscal period. Net income includes cash income and noncash income. In the reconciliation, adjustments are made for changes in non-cash balance sheet accounts that impact net income and for non-cash income, expenses, gains, and losses.

Net income is equal to the change of Retained Earnings (in the Balance Sheet) adjusted for distributions to owners (*Ending Retained Earnings + Distributions to Owners – Beginning Retained Earnings = Net Income*). The sample Balance Sheet shows net income as a component of the calculation of ending Retained Earnings.

The net income presented in the Reconciliation of Net Income to Cash Flow from Operating Activities must equal the net income presented in an Income Statement (or shown in a modified-format Balance Sheet). However for the purposes of financial statements accompanying Growth Through Agriculture applications, differences of \$1 can be ignored as rounding errors.

Reconciliation of Net Income to Cash Flow from Operating Activities can intellectually difficult, even for individuals with some accounting knowledge. The template spreadsheet is designed to automate the process of the reconciliation and reduce errors. However, the account balances in the balance sheet must be correct in order for the Net Income calculated in the reconciliation to match the Net Income calculated in the Balance Sheet. If you have difficulties reconciling Cash Flow from Operating Activities to Net Income, do not hesitate to contact qualified individuals for help.

BALANCE SHEET

A balance sheet consists of the following main components. $\text{Assets} = \text{Liabilities} + \text{Owner Equity}$

- Assets
- Liabilities
- Owner Equity

Assets

Assets are everything owned by a business that have value or will provide future economic benefit. Assets are the result of transactions or events that have already occurred. There are three major classes of assets: current assets, fixed assets, and intangible assets.

Current Assets

Current assets are assets that are expected to be converted to cash, sold, or consumed either in a year. Current assets include cash (or accounts that are equivalent to cash, such as money market accounts or short-term Certificates of Deposit), short-term investments, accounts receivable, prepaid expenses, inventory, and other miscellaneous current assets.

- Accounts Receivable are amounts owed to the business by customers for products or services provided. In many situation the balance of Accounts Receivable should be reduced by an allowance for doubtful accounts (amounts owed that will not be paid).

However for the purpose of the financial statements to be submitted with the Growth Through Agriculture application, this adjustment does not need to be shown.

- Prepaid expenses are costs that are paid for before they are actually used or incurred. Examples include prepaid insurance premiums, security deposits made with vendors supplying products or services to the business, or multi-year subscriptions. For the purpose of the financial statements to be submitted with the Growth Through Agriculture application, these sort of costs only need to be presented as an asset if they are significant, otherwise the costs can be expensed.
- Inventory is assets that are traded in the course of normal business by the business. Inventory includes raw materials, work in process, finished goods, and goods purchased for resale. Inventory is valued at cost, not retail value. Ending Inventory = Beginning Inventory + Purchases – Cost of Goods Sold

Long Term Investments

Long Term Investments includes investments in securities (such as mutual funds, stocks, and bonds), fixed assets, and intangible assets. Long-term investments are to be held for many years and are not intended to be disposed in the near future. For the purposes of the Balance Sheet to be submitted with the Growth Through Agriculture application, “Investments” refers to investments in securities.

Fixed Assets

For the purposes of the Balance Sheet to be submitted with the Growth Through Agriculture application, fixed assets are labeled Plant, Property, and Equipment and include land, buildings, equipment, livestock held for breeding or other productive use (such as milking), and accumulated depreciation. Livestock held for resale (such as feeder steers) should be classified as inventory at cost, not as a fixed asset. Fixed assets are recorded at cost, not market value.

Fixed assets are expensed (depreciated) over time to match the income produced by the assets over a period of time. However, land is never depreciated. Depreciation is calculated as follows: $Annual\ Depreciation = Cost \div Anticipated\ Useful\ Life$. Accumulated Depreciation is the sum current and all prior depreciation taken on fixed assets. Depreciation calculated for income tax purposes is typically accelerated, meaning that it occurs over a shorter period of time than accounting depreciation. In many situations, the majority of tax depreciation is taken in the initial years of the useful life defined by tax law, which is generally shorter than the economic useful life used for accounting depreciation.

Intangible Assets

Intangible Assets lack physical substance and convey valuable rights and privileges to the business. Examples of Intangible Assets include intellectual property (such as patents, copyrights, trademarks, franchises) and organization costs. Intangible assets are recorded at cost (whether it be purchase price or the cost to develop). Similar to Fixed Assets, Intangible Assets are expensed (amortized) over a period of time. Determining an appropriate period of amortization is more difficult than determining the useful life of fixed assets. Unlike Fixed Assets, there is no presentation of accumulated amortization; Intangible Assets are presented net of amortization expense.

Goodwill is a special category of intangible assets. Goodwill only arises when a business is purchased for a price that is greater than the “book value” of the business being purchased (*Book Value = Assets – Liabilities*). Therefore, if the business has not been purchased from another party, no value should be presented as Goodwill. Goodwill is not amortized, but can adjusted if it is determined that the value of Goodwill is impaired (a complex accounting subject). The commonly perceived meaning of “goodwill” which may be more accurately described as “social capital” is not recorded in financial statements.

Liabilities

Liabilities are probable future sacrifices of economic benefits that arise from obligations resulting from transactions or events that have already occurred. The settlement of these obligations may result in the transfer or use of assets or providing services to another party in the future. There are two major classes of assets: current liabilities and long term liabilities.

Current Liabilities

Current Liabilities are liabilities (obligations) that are expected to require the use of current assets or creation of additional current liabilities. Current liabilities are typically expected to be settled within one year. Current liabilities include Accounts Payable, Operating Loans or Lines of Credit, Unearned Revenue, the Current Portion of Long Term Debt, and other miscellaneous current liabilities.

Accounts Payable are amounts owed by the business to vendors (suppliers and service providers) for products or services provided to the business.

Operating Loans / Lines of Credit For the purposes of the Balance Sheet to be submitted with the Growth Through Agriculture application, credit card debt can be included with Operating Loans / Lines of Credit.

Unearned Revenue (Deferred Revenue) is an obligation that is created when the business receives payment (a deposit) for goods or services prior to when those goods or services are provided to the customer. When the ownership of goods transfers to the customer or services are provided to the benefit of the customer, revenue is recognized and the balance of Unearned Revenue is decreased. For the purposes of the Balance Sheet to be submitted with the Growth Through Agriculture application, Unearned Revenue can be classified as “Other Current Liabilities” and only needs to be recorded if they are significant (similar to Prepaid Expenses).

Current Portion of Long Term Debt is the total of *principal* payments that are required to be paid within one year on long term debt. To make sure that the total liability balance is correct, the balance of the long term debt in the Long Term Liabilities section of the Balance Sheet needs to be adjusted (reduced) by the Current Portion of Long Term Debt to prevent liabilities from being overstated.

Loan amortization schedules are necessary to determine the correct amounts to include in the Current Portion of Long Term Debt. Loan amortization schedules are reports that show the schedule of payments to be made on loans and include information on the required date of

payments, total payment amounts, interest portion of the payments, principal portion of the payments, and balance of the loan after each payment.

Long Term Liabilities

Long Term Liabilities are liabilities (obligations) that are not expected or required to be liquidated (paid) within a year. Examples of long term liabilities include debt used to finance land, buildings, and equipment, long term bonds and notes issued to finance the business (including debt instruments that are convertible to equity ownership), and long term product warranties (the value of which requires estimation). For the purposes of the Balance Sheet to be submitted with the Growth Through Agriculture application, Long Term Liabilities is lumped into one total number. Applicants should be prepared to discuss and describe the makeup and terms of long term liabilities.

Owner Equity

Owner Equity is a measure of owners' interest in the business. Owner Equity is an indirect measurement that is the difference between Assets and Liabilities (*Owner Equity = Assets – Liabilities*). Categories of owner equity depend on the legal form of entity chosen for the business. However, there are two main categorizations of Owner Equity that need to be described for the purposes of the Balance Sheet to be submitted with the Growth Through Agriculture application: Owner Contribution and Retained Earnings.

Owner Contribution is the amount owners contribute to the business in return for ownership rights. Owner Contribution may be in the form of cash or other assets (net of associated obligations contributed to the business). The balance of Owner Contribution should only be reduced if there is a distribution that is a return of capital, as opposed to a distribution of retained earnings.

Retained Earnings represent the business's accumulated earnings, less distributions of earnings made to owners. Different legal forms of entities use different terminology for "distributions". Sole proprietorships, partnerships, and limited liability companies use the term "owner draws". Draws can include return of capital (return of owners' contribution), but for the purpose of the Balance Sheet to be submitted with the Growth Through Agriculture application, distributions for draws should only include distributions of retained earnings. Corporations use the term "dividends" to define distributions of retained earnings.

For the purposes of the Balance Sheet to be submitted to the Growth Through Agriculture application, the balance sheet should provide the following information to show the calculation of Retained Earnings: Beginning Retained Earnings, Net Income, Distributions to Owners, and Ending Retained Earnings. (*Beginning Retained Earnings + Net Income + Distributions to Owners = Ending Retained Earnings*)

There can be different classes of ownership that provide different rights and privileges to the owners. This information is not required to be presented in the Balance Sheet to be submitted with the Growth Through Agriculture application, but applicants should be prepared to discuss and describe different classes of ownership, if differences exist (different classes of common stock, preferred stock, allocation of profits, allocation of rights of ownership of business

property, guaranteed payments, limitations on transfer of ownership, percentages of ownership, existence of controlling interests, convertible debt).

SPREADSHEET TEMPLATE GUIDE

Cash Flow Statements and Balance Sheets accompanying Growth Through Agriculture applications are only required to show financial information for individual years. For adequate financial planning, applicants may find it useful to prepare cash flow statements and balance sheets for individual months, particularly for the first twelve months if the business is a startup. Commercial lenders will almost certainly require monthly projections for the first twelve months, if not longer. Monthly projections will help applicants achieve a better and more realistic understanding of their business that will help them adequately plan cash and debt management.

It is recommended that spreadsheet users work through each year sequentially and avoid the temptation to fill in amounts across the years.

Spreadsheet cells with colored backgrounds are input cells where the spreadsheet user can enter information. Spreadsheet cells with white backgrounds contained formulas that make calculations or formulas that reference other cells. To help prevent errors, spreadsheet cells with white backgrounds are “locked” so that the formulas or references cannot be accidentally changed or erased.

The spreadsheet contains two worksheets that reference each other (Cash Flow and Balance Sheet). If you are not familiar with “worksheets”, worksheets are like individual pages of the spreadsheet.

- If you cannot see the worksheet tabs at the bottom of the window on the computer screen, make sure that the window for the spreadsheet is “maximized”. The spreadsheet window is maximized if there is an icon that looks like two pages overlapping in the upper right-hand part of the screen. This icon will actually be immediately below similar icons that indicate whether the Excel window is “maximized”.

Sequence For Using the Spreadsheet Template – Short Description

- Enter the business’s name (Cash Flow – Cell A1) & (Balance Sheet – Cell A1)
- Start with the Cash Flow worksheet.
 - If the business is an existing business, enter historic information from the most recent completed fiscal year into the Prior Year column
 - If the business is a startup business, enter projected information into the Year 1 column
 - Enter the Beginning Cash balance
 - Enter cash transaction amounts into appropriate cells in the following sections of the Cash Flow Statement
 - Cash Flow from Operating Activities
 - Cash Flow From Investing Activities
 - Cash Flow From Financing Activities

- If entering historic information into the Prior Year column, make sure Ending Cash balance is correct.
- Switch to the Balance Sheet worksheet
 - Enter the ending balances for balance sheet accounts in the appropriate column and cells.
 - If entering historic information into the Prior Year column, make sure that the balances for Beginning Retained Earnings, Net Income, and Ending Retained Earnings are correct.
- Switch back to the Cash Flow worksheet to reconcile net income to cash flows from operating activities.
 - Whether the adjustments are positive adjustments or negative adjustments, all adjustments are entered as positive numbers.
 - Only enter adjustments that fit the description provided.
 - Adjustments that are based on changes in balance sheet accounts are determined by comparing the ending balance of the balance sheet account to the ending balance of that account for the previous year.
 - Starting in Year 2, these adjustments are automatically calculated based on ending balances entered in the Balance Sheet worksheet.
 - Check to make sure that Net Income calculated in the Cash Flow worksheet reconciles to Net Income calculated in the Balance Sheet worksheet.
 - Compare Net Income (*As Adjusted From Net Cash Flow From Operating Activities*) (Cash Flow – Row 114) **to** Net Income (*From Balance Sheet*) (Cash Flow – Row 118)
 - (Cash Flow - Row 120) calculates the difference.
 - If the difference is \$0 or \$1 (a rounding error), a successful reconciliation of Net Income to Net Cash Flow From Operating Activities has been achieved.
 - If the difference is greater than \$1, the reconciliation has failed and there are two possible sources of error:
 - An error in the adjustments
 - Incorrect amounts entered into the Balance Sheet, confirm all amounts but particularly look at the following accounts and amounts.
 - Beginning and ending Cash (Cash Flow - Row 76) and (Cash Flow - Row 77)
 - Accumulated Depreciation (Balance Sheet - Row 25)
 - Current Portion of Long Term Debt (Balance Sheet - Row 43)
 - Long Term Liabilities (Balance Sheet - Row 47) (make sure it has been adjusted/reduced to take into account the Current Portion of Long Term Debt)
 - Owners Contribution (Balance Sheet - Row 53) (make sure that if additional funds have been invested by the owners that the ending balance is adjusted/increased)
 - Retained Earnings – Beginning Balance (Balance Sheet – Cell B55) and (Balance Sheet – Cell C55).

- Repeat sequence for the following year.

Sequence For Using the Spreadsheet Template – Detailed Description

- Enter the business's name (Cash Flow – Cell A1) & (Balance Sheet – Cell A1)
- Start with the Cash Flow worksheet.
 - Enter the Beginning Cash Balance
 - If the business is an existing business and you are entering historic information into the “Prior Year” column. (Cash Flow - Cell B76)
 - If the business is a startup business and you are entering the first year of projections. (Cash Flow - Cell C76)
 - Enter information into appropriate cells for – keeping in mind that the amounts being entered are only for transactions in which cash is involved and are only for the amount of cash involved in the transaction.
 - Cash Flow from Operating Activities
 - Cash Flow From Investing Activities
 - Cash Flow From Financing Activities
 - Examine the Ending Cash Balance
 - If information is being entered for an existing business in the “Prior Year” column, make sure that the Ending Cash Balance matches your actual balance.
 - In most cases, to be viable, a business must have a positive cash balance
 - If the business is an existing business entering historic information into the “Prior Year” column, enter the Ending Cash Balance in the Prior Year column (Cash Flow - Cell B77) into the Beginning Cash Balance cell in the “Year 1” column (Cash Flow - Cell C76).
- Switch to the Balance Sheet worksheet
 - Enter the ending balances for balance sheet accounts.
 - The ending balance for Cash automatically transfers to the Balance Sheet
 - If the business is an existing business, enter historic ending balances for the most recent completed fiscal year into the “Prior Year” column.
 - If the business is a startup business, enter projected ending balances into the “Year 1” column.
 - Remember that the ending balance for accumulated depreciation = previous year's accumulated depreciation ending balance + current year's depreciation expense
 - Remember that the ending balance for intangible assets = previous year's intangible asset ending balance + cost of new intangible assets – current year's amortization expense
 - Remember that there should only be a balance for Goodwill if the business was purchased previously and the purchase price created Goodwill. Also, Goodwill is not amortized.
 - Remember to adjust Long Term Liabilities for amounts entered into Current Liabilities as the Current Portion of Long Term Debts.
 - At the individual loan level: ending Loan Balance = Current Portion + Long Term portion. Make sure to use a loan amortization schedule to

- determine the Current Portion (the principal payment portion of the following year's scheduled loan payment).
- Owners' Contribution is the amount invested by the owners – normally the original amount invested, plus any additional investments.
 - Retained Earnings – Beginning Balance
 - If the business is an existing business, enter the historic ***beginning balance*** for the most recent completed fiscal year into the “Prior Year” column (Balance Sheet - Cell B55).
 - Make sure that Net Income (Balance Sheet – Cell B56) matches Net Income recorded in the business's accounting system, and make sure that Retained Earnings – Ending Balance (Balance Sheet – Cell B58) matches the balance in the business's accounting system. If Distributions To Owners were made, those distributions should be recorded in (Cash Flow – Cell B65). If the Net Income and Retained Earnings – Ending Balance do not match accounting records, there must be an error within the amounts entered in the Balance Sheet. Carefully confirm each balance.
 - If Net Income and Retained Earnings – Ending Balance match accounting records, enter the amount of Prior Year's Retained Earnings - Ending Balance (Balance Sheet – Cell B58) into the cell for Year 1 Retained Earnings – Beginning Balance (Balance Sheet - Cell C55).
 - If the business is a startup business, enter \$0 into the cell for Year 1 Retained Earnings – Beginning Balance (Balance Sheet - Cell C55).
 - Switch back to the Cash Flow worksheet to reconcile net income to cash flows from operating activities
 - Positive Adjustments (Cash Flow – Rows 87 – 96) (*all entered as positive numbers*)
 - If the ending balances of Accounts Receivable, Prepaid Expenses, or Inventory increased (compared to the ending balance of the previous year) enter the amount of increase into the appropriate cells.
 - Starting in Year 2, the adjustments for changes in the ending balances of these accounts is automatically calculated based on amounts entered in the Balance Sheet worksheet.
 - If the ending balances of Accounts Payable or Other Current Liabilities decreased (compared to the ending balance of the previous year) enter the amount of decrease into the appropriate cells.
 - Starting in Year 2, the adjustments for changes in the ending balances of these accounts is automatically calculated based on amounts entered in the Balance Sheet worksheet.
 - Enter the amounts of investment income accrued, gains on sale of assets, income realized from cancellation of debt, and other non-operating income.
 - Grant income is automatically entered as being equal to cash received from grant income (Cash Flow – Row 54).
 - Negative Adjustments (Cash Flow – Rows 100 – 109) (*all entered as positive numbers*)

- Enter Depreciation and Amortization Expense
- If the ending balances of Accounts Receivable, Prepaid Expenses, or Inventory decreased (compared to the ending balance of the previous year) enter the amount of decrease into the appropriate cells.
 - Starting in Year 2, the adjustments for changes in the ending balances of these accounts is automatically calculated based on amounts entered in the Balance Sheet worksheet.
- If the ending balances of Accounts Payable or Other Current Liabilities increased (compared to the ending balance of the previous year) enter the amount of increase into the appropriate cells.
 - Starting in Year 2, the adjustments for changes in the ending balances of these accounts is automatically calculated based on amounts entered in the Balance Sheet worksheet.
- Enter the amounts of investment losses accrued, losses on sale of assets, and other non-operating expenses and losses.
- Return of grants is automatically entered as being equal to cash used to return grant funds (Cash Flow – Row 64).
- Compare Net Income (*As Adjusted From Net Cash Flow From Operating Activities*) (Cash Flow – Row 114) to Net Income (*From Balance Sheet*) (Cash Flow – Row 118)
 - (Cash Flow - Row 120) calculates the difference.
 - If the difference is \$0 or \$1 (a rounding error), a successful reconciliation of Net Income to Net Cash Flow From Operating Activities has been achieved.
 - If the difference is greater than \$1, the reconciliation has failed and there are two possible sources of error:
 - An error in the adjustments
 - Incorrect amounts entered into the Balance Sheet.
 - Net Income shown in the Balance Sheet worksheet is a calculated number that ensures Assets = Liabilities + Owner Equity. Therefore, even though the Balance Sheet is “balanced”, it may be balanced with incorrect amounts that prevent Net Cash Flow From Operations to be reconciled to Net Income, even if the adjustments are correct.
 - All ending balances of balance sheet accounts should be confirmed; however there are some accounts that may be more likely to cause an error.
 - The ending Cash balance is referenced from the Cash Flow worksheet. Make sure that beginning and ending Cash balances in (Cash Flow – Row 76) and (Cash Flow - Row 77) are correct – particularly the beginning cash balances for Prior Year (Cash Flow – Cell B76) and Year 1 (Cash Flow – Cell C76).
 - Accumulated Depreciation

- Current Portion of Long Term Debt
- Long Term Liabilities (make sure it has been adjusted/reduced to take into account the Current Portion of Long Term Debt)
- Owners Contribution (make sure that if additional funds have been invested by the owners that the ending balance is adjusted/increased)
- Retained Earnings – Beginning Balance (Balance Sheet – Cell B55) and (Balance Sheet – Cell C55).
 - If the business is an existing business that enters information into the “Prior Year” column, the amount entered into the beginning balance of Retained Earnings for Year 1 (Balance Sheet – Cell C55) must equal the ending balance of Retained Earnings for “Prior Year” (Balance Sheet - Cell B58)
- Repeat sequence for the following year.